

**EPA'S 2002 FINAL RULE NSR REFORMS:**  
**THE CASE FOR STATE AND LOCAL AGENCY ADOPTION**  
**NSR ISSUE PAPER NO. 1**

**PREPARED FOR THE**  
**CLEAN AIR IMPLEMENTATION PROJECT**

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## ABOUT THE CLEAN AIR IMPLEMENTATION PROJECT

The Clean Air Implementation Project (CAIP) is an organization of major industrial corporations which joined together in 1991 to focus on a broad range of issues under the 1990 Clean Air Act Amendments. The issues addressed by CAIP cut across industry lines and, thus, will generally affect each of the members in a similar fashion.

All of the CAIP members have facilities potentially subject to the federal New Source Review (NSR) requirements, including the recently-adopted NSR reforms. CAIP is committed to working with EPA and state and local permitting authorities in a constructive fashion in connection with implementation of the NSR reforms. These reforms are of vital concern to CAIP's members because of their significance to facilitating the implementation of this important regulatory program.

Throughout the decade-long deliberations over NSR reforms, CAIP and its counsel participated in every aspect of the process. CAIP's counsel served as a member of EPA's NSR reform subcommittee, and CAIP submitted comments on every NSR draft and proposal EPA issued. Since 1996, CAIP's counsel has participated as a member of the small and large group stakeholder discussions on NSR reform and now serves as co-chair of EPA's subcommittee of the Clean Air Act Advisory Committee that deals with NSR issues.

Since its formation, CAIP has placed particular emphasis on developing materials that would potentially be useful to state and local permitting authorities. One example: Following EPA's adoption of the Title V program requirements, CAIP developed a State Permit Program Manual that was widely used by EPA and state and local permitting agencies in developing state programs that implement the federal Title V regulations.

In 1995, CAIP members formed the Clean Air Act Information Network, an organization with one of its principal purposes to facilitate a dialog among EPA, state and local officials, and industry representatives on key clean air implementation issues. This dialog is achieved through two-day conferences that are held once or twice a year. At each conference, senior EPA air officials from the Assistant Administrator to program managers, state and local officials, and industry representatives participate in plenary and workshop sessions. A topic of major focus at virtually every one of these conferences has been EPA's NSR rulemaking and enforcement activities.

CAIP's current members are: Air Products and Chemicals, Inc.; ChevronTexaco; The Dow Chemical Company; Eastman Chemical Company; E I duPont de Nemours, Inc.; El Paso Corporation; ExxonMobil Corporation; Honeywell International Inc.; Monsanto Company; Owens-Illinois, Inc.; Pfizer Inc.; Pratt & Whitney; The Procter & Gamble Company; Shell Chemical Company; and United Technologies Corporation. The law firm of Morgan, Lewis & Bockius LLP, serves as counsel to CAIP, with Bill Lewis and John Quarles leading this effort.

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## INTRODUCTION

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EPA's adoption of the reforms in the 2002 final new source review (NSR) rule was the culmination of a decade of deliberations over how to improve the federal NSR program. 67 Fed. Reg. 80,185 (Dec. 31, 2002). All interested parties -- EPA, state and local agencies, industry, and environmental organizations -- agreed that the program needed significant reform. CAIP members feel strongly that the reforms adopted establish good public policy that will achieve the NSR benefits Congress intended and do so in a way that is authorized under the Clean Air Act (Act).

Some state and local officials and environmental groups have raised questions about key aspects of the reforms. STAPPA/ALAPCO has developed a "Menu of Options" that seems to reject the most important improvements reflected in the final rule. In effect, the "options" that apparently are preferred would reinstate the unworkable NSR scheme that had been applied under the prior rule, which recent federal court decisions have held is unlawful and contrary to Congress' clear intent. CAIP members urge that state and local agencies adopt the reforms as promulgated by EPA. If it later appears that minor adjustments are warranted, any fine tuning can be made after there is real world experience with the revised program.

This first issue paper will primarily address the two reforms in the 2002 final rule that revise the provisions governing the basic determination of NSR applicability to non-excluded changes: (1) the "baseline actual emissions" definition, and (2) the "actual-to-projected-actual" emissions increase methodology. We will explain why we believe the reforms will achieve the benefits intended under the Act and will do so in a manner that is a significant improvement and lawful. In discussing them, we will review issues that state and local authorities have raised. In addition, we will explain why "options" that STAPPA/ALAPCO has recommended for consideration are unlawful, impractical, or both.

The paper will also briefly address the three other reforms in the 2002 final NSR rule: (1) Plantwide Applicability Limitations (PALs); (2) Clean Units; and (3) the Pollution Control Project (PCP) exclusion. We will devote less attention to these three important reforms because we believe there is more general agreement about the reasonableness of each of them.

CAIP will issue a second paper that addresses EPA's recent adoption of the Equipment Replacement Provision (ERP) of the routine maintenance, repair and replacement exclusion. That paper will explain why the ERP will provide important benefits, is lawful and, indeed, reflects the policy EPA and states implemented until EPA launched its NSR enforcement initiative against electric utilities and other facilities in the late 1990s.

## I. BASELINE ACTUAL EMISSIONS

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**Overview of Reform.** EPA's final rule provides that, in determining NSR applicability, pre-change emissions at non-utility sources shall be determined under the new provisions for "baseline actual emissions." This new term is defined as the average annual emissions actually emitted during any consecutive 24-month period selected by the source within the 10-year period preceding construction. As explained below, downward adjustments of such emissions must be made under certain circumstances.

**Key Features.** The baseline emissions provision contains a number of safeguards to assure that the baseline (1) will be reflective of actual emissions levels that are permissible at the time of the change and (2) will be determined through a process that can be implemented without undue complexity for permitting authorities. Two safeguards are possibly the most important. First, the source may not select any 24-month period for which there is "inadequate information" for determining annual emissions. Second, actual emissions in the 24-month period selected must be adjusted downward to take into account any later-established federal and state emission limitations.

**Response to STAPPA/ALAPCO.** We understand that STAPPA/ALAPCO has raised several objections to the baseline provision. We discuss each below:

- **Complexity** – Contrary to concerns that have been expressed, the new baseline provision for non-utility sources is no more complex than its predecessor. Under the new provision, the source can choose any consecutive 24-month period during the prior 10 years for which there is adequate information, whereas, under the prior rule, the source was required to select a "representative" two-year period or another period (*i.e.*, shorter or longer than two years) that is "more representative of normal operations." While EPA often asserted that sources were to choose the most recent two-year period, the rule did not require that this period be selected. Eliminating the necessity for making the difficult judgment as to what period is "representative" of normal operations may make the determination of what period should be selected simpler than under the prior rule.
- **Enforceability** – The enforceability of the new baseline provision is no different than it was under the prior provision. Both provisions require that the source assemble necessary actual emissions data to establish the baseline. By requiring that there be adequate information available for the period selected, the final rule ensures that sources must provide necessary support for the baseline level.

- **Appropriateness of selecting any consecutive two-year period in the past ten years** – The 2-in-10 authorization is more supportable as a baseline from an environmental and fairness standpoint than use of the two most recent years. Two benefits are particularly significant. First, the provision eliminates incentives to keep emissions high to assure that the baseline for future changes will be as high as possible, thereby providing a real air quality benefit. Second, the new provision does not penalize businesses whose operations are cyclical or whose capacity has recently been underutilized. Since the source must have “adequate information” for the two years selected and must reduce emissions in the period selected to take account of later-adopted emissions limitations, the new provision assures that an appropriate baseline reflective of actual emissions during a period of normal operations will be established.
- **Inclusion of fugitive emissions and emissions from startups, shutdowns, and malfunctions (SSM)** – The principal concern here seems to be that the baseline may be too high with these types of emissions considered and that fugitive emissions and SSM emissions may inappropriately be projected to be less following a change than before. In the real world, this could not occur without the source risking serious consequences. Sources must have adequate information to include such emissions in the baseline and must have a sound basis for any determination that there would be lower emissions after a change. Sources will be subject to enforcement if they attempt to claim illusory baseline emissions or emission reductions.

**STAPPA/ALAPCO Proposal.** STAPPA/ALAPCO has suggested a major change to the baseline provision. The proposed approach would clearly conflict with the final NSR rule and, in our judgment, would be unlawful under the Clean Air Act. STAPPA/ALAPCO’s principal change would be to provide that the source’s baseline must be the annual average of the last two years of actual emissions, with a vague possibility for selecting a different period where deemed justifiable because of the source’s business cycle. Revising the baseline provision in this manner would obviously conflict with EPA’s reform of the baseline provision. It also would be unsound public policy for the reasons indicated above. The conflict with the Clean Air Act would arise from the fact that Congress based the NSR “modification” provisions on the NSPS definition, which establishes a “potential” emissions baseline. Thus, for the baseline to be lawful, EPA must provide that the NSR baseline will be the source’s potential emissions, or at least a level that is reasonable in the context of Congress’ incorporating the NSPS definition in the NSR program. Since emissions in the two most recent years often would in no way be reflective of either a source’s potential or a real world maximum, establishing that period as the baseline against which to compare future emissions would clearly be unreasonable and, thus, unlawful. STAPPA/ALAPCO proposes that SSM emissions not be taken into account in the baseline, but this seems legally suspect because such emissions

were actual emissions that occurred. EPA has explicitly excluded any "non-compliant emissions," and this includes any SSM emissions that were in violation of applicable requirements.

## II. "ACTUAL-TO-PROJECTED-ACTUAL" APPLICABILITY TEST

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**Overview of Reform.** The final NSR rule provides that the determination of whether an emissions increase results from a physical change or change in the method of operation is to be made through an "actual-to-projected-actual" applicability test. This test is essentially the same as the test promulgated in the 1992 WEPCO rule for electric utility generating units. This test also is analogous to the methodology for determining emissions increases under the 1980 NSR rule. EPA initially interpreted the 1980 rule to provide for such an actual emissions test, but began incrementally in the late 1980's to embrace the "actual-to-potential" test.

**Key Features.** Post-change emissions for existing units are to be determined by projecting an annual rate that reflects the maximum annual emissions rate that will occur during any 1 of the 5 (or, under certain circumstances, 10) years immediately after the physical or operational method change. Any emissions that could have been accommodated during the selected 24-month period and are "unrelated to the change" shall be excluded in making the post-change emissions calculation. Where there is "a reasonable possibility" that a project may result "in a significant emissions increase," but the source determines that the project would not trigger NSR applicability, the source is required to record information that shows that the project will not result in a significant net emissions increase. Non-utility sources must submit a report to the permitting authority for any 1 of the 5 (or, where appropriate, 10) years following a change when an increase in a post-change annual emissions rate for the year (1) exceeds the baseline actual emissions by a significant amount, and (2) is inconsistent with the projection that was calculated before the change.

**Response to STAPPA/ALAPCO.** Although it has raised concerns with various aspects of the "actual-to-projected-actual" test, STAPPA/ALAPCO does not seem to have directly challenged the reasonableness of the test as a basis for determining whether there would be a significant emissions increase that would result from a change. We have reviewed the issues that STAPPA/ALAPCO has raised regarding various aspects of the tests and have concluded that the aspects challenged are (1) no different than under the prior NSR rule, (2) responsive to rulemaking comments of state permitting authorities, or (3) mandatory under the Clean Air Act. We respond below to the principal issues STAPPA/ALAPCO has raised:

- **Determination of applicability** – The basic approach to enforcing NSR requirements under the final rule is similar to the approach that existed previously. In either case, a source is to make an initial



determination regarding whether a proposed change would require that the source apply for an NSR permit. If the source's determination ultimately turns out to be incorrect in the view of EPA or a state or local agency, the source may be subject to enforcement for violating NSR. 67 Fed. Reg. 80,190. This approach to determining applicability is not unusual and does not involve "self-policing," as some have asserted. It is the approach that EPA has used under numerous other programs. Under the NSPS program, for example, sources are not required to engage in any recordkeeping or reporting when they determine that a change will not constitute a "modification."

- **Notification to agency** – Contrary to assertions that some have made, non-utility sources have not been required in the past to inform EPA or state agencies of every proposed physical or operational method change, or to notify agencies of determinations of non-applicability. The new rule actually requires more recordkeeping and reporting than the prior rule. The final rule requires that records be kept even if the source concludes that the proposed project will not cause a significant emissions increase so long as there is a "reasonable possibility" that it might. Also, sources must report subsequent emissions increases if they are significant and differ from the source's projections. *See, e.g.,* 40 C.F.R. § 52.21(r)(6)(v); 67 Fed. Reg. 80,279. In limiting the recordkeeping and reporting requirements to circumstances where the "reasonable possibility" prerequisite is satisfied, EPA was responsive to comments of permitting agencies and regulated sources. For example, in supporting the "actual-to-projected-actual" test, New York indicated that the "administrative monitoring and recordkeeping" under the WEPCO rule requiring reports for all non-routine changes would be "excessive" when applied not just to utilities, but to all sources. As a consequence, New York requested "that the reporting and recordkeeping be minimized." New York Comments on 1996 NSR Proposal at p.7.

- **Enforceability** – EPA and states will have the same enforcement tools as in the past to ascertain whether a particular project triggers NSR requirements. First, as in the past, state and local agencies will have an opportunity to review NSR applicability when sources apply for minor NSR permits. In the past, as will be true in the future, minor NSR permitting provided the principal opportunity for permitting authorities to review and consider the potential applicability of NSR to proposed changes that sources believe do not require major NSR permitting. Also, when making a change, a source often will be required to apply for revisions of its Title V operating permit. In addition, as EPA has frequently done in the recent past, the Agency can require the submission of information under section 114 of the

Act. State and local permitting authorities have similar opportunities to obtain information from major sources.

- **Inclusion of the "demand growth" exclusion** -- The final rule provides that projections of emissions increases after a change are to be adjusted for emissions that could be "accommodated" prior to the change that are "unrelated to the change." The final rule preamble states that this provision is to assure that the source "only count[s] emissions increases that will result from the project." 67 Fed. Reg. 80,196. Inclusion of this "demand growth" exclusion is consistent with EPA's longstanding policy on causation, under which only emissions increases that "result from" a change are to be taken into account in determining whether a change triggers NSR permitting. Furthermore, exclusion of such emissions is mandatory under the Clean Air Act. The Act requires that the change be responsible for an emissions increase for the increase to be taken into account in determining NSR applicability. 67 Fed. Reg. 80,203.

**STAPPA/ALAPCO Proposal ("Actual-to-Potential" Test).** Although STAPPA/ALAPCO does not appear to directly challenge the "actual-to-projected-actual" test, it does propose as its principal improvement the adoption of the "actual-to-potential" test to determine NSR applicability. Although this test was in widespread use by state and local permitting authorities under the prior rule, it is not lawful under either EPA's prior regulations or the Clean Air Act.

- **EPA's Prior Regulations.** EPA's former regulations provided that, in determining emissions increases, post-change emissions of existing emissions units are to be deemed equivalent to a source's potential emissions only where the unit has "not begun normal operations." EPA initially interpreted the 1980 NSR rule to provide that there must be an increase in actual emissions that results from the change and specifically ruled that increases in emissions due to an increase in hours of operation or production rate were not to be considered. In the late 1980s, in issuing NSR applicability determinations, EPA began to take the position that an "actual-to-potential" test should be applied.
- **Illegality of "Actual-to-Potential" Test for Existing Emission Units Under Court Decisions.** In the WEPCO case (*Wisconsin Elec. Power Co. v. Reilly*, 893 F.2d 901 (7th Cir. 1990)), the court ruled that use of an "actual-to-potential" test in determining emissions increases at an emissions unit with an operating history is unlawful and that an "actual-to-actual" test must be applied. Subsequently, in the WEPCO rule preamble, EPA stated that the "actual-to-potential" test is only to be applied where changes at an existing unit are "sufficiently significant to support a finding that normal operations have not begun." 57 Fed. Reg. 32, 314. Nonetheless, in recent years, EPA has increasingly taken the position that the "actual-to-potential" test must be

applied under the 1980 NSR rule when determining emissions increases from changes at any existing emissions unit.

Two recent cases confirm that it is unlawful for the actual-to-potential test to be applied in determining NSR applicability to proposed changes at existing emissions units. In *U.S. v. Ohio Edison Co.* (Aug. 7, 2003 S.D. Ohio), EPA brought an enforcement action arguing that the company's replacement projects over a number of years should have been permitted under the NSR requirements. Although the judge accepted virtually every factual and legal argument EPA put forward, he nonetheless ruled that, since the plant "was operational at the time the activities were proposed," "any use of the actual to potential to emit test is not legally supportable." Slip op. at 60. The judge's ruling is further particularly notable because he issued this ruling even though EPA had abandoned the argument made in its briefs that the judge should apply the actual-to-potential test. *Id.*

In *U.S. v. Duke Energy Corp.*, No. 1:00CV01262 (M.D.N.C.), the judge ruled that, under the 1980 NSR rule, an "actual-to-actual" test should be applied under which a comparison is made of pre-project actual emissions and future actual emissions, assuming constant hours and conditions of operation. Slip op. at 48. EPA had argued that an "actual-to-projected-actual" test should be applied, after abandoning the argument in its brief that an "actual-to-potential" test should be applied. *Id.* at 47, n.17. The court ruled,

based on the PSD rules, the contemporaneous interpretation of the PSD rules, and the statutory language incorporating the NSPS concept of modification into PSD, post-project emissions must be calculated on an annual basis, measuring emissions in tons-per-year, and in calculating post-project emissions levels, the hours and conditions of operation must be held constant. *Accordingly, a net emissions increase can result only from an increase in the hourly rate of emissions.*

*Id.* at 48 (emphasis added).

- **"Actual-to-Potential" Test Upheld Only For New Units.** Courts have upheld EPA application of the "actual-to-potential" test in two cases, but only where the emissions unit involved was a new unit or a unit that was changed so significantly that it could be treated as a new unit. In *Puerto Rican Cement Co. v. EPA*, 889 F.2d 292 (1st Cir. 1989), the court ruled that the substantial changes to a cement plant, converting it from a wet process to a more efficient dry process, resulted in a new unit, i.e., one that had "not begun normal operations." *Id.* at 298. Similarly, in *U.S. v. Murphy Oil USA, Inc.*, 143 F. Supp. 2d 1054 (W.D. Wis. 2001), the judge ruled that changes to the facility's sulfur recovery unit, including a significant increase in capacity, were "significant enough to make the post-construction unit effectively a

new unit that had not begun normal operations at the start of construction.”  
*Id.* at 1105.

- **Conflict with Clean Air Act.** STAPPA/ALAPCO’s proposal to codify the “actual-to-potential” test in NSR regulations would clearly conflict not just with EPA’s final rule, but also with the mandate under the Clean Air Act. Congress only provided for emissions increases that result from a change to be taken into account in determining whether NSR permitting is triggered. This clear requirement is embodied in the “modification” definition in section 111(a)(4). Congress embraced this definition, which was adopted as a part of the NSPS requirements, as the basis for determining whether physical or operational method changes are to be subject to NSR permitting. In incorporating the NSPS definition in the NSR program, Congress was explicitly including a definition that had been interpreted to require a “potential-to-potential” test for determining emissions increases. Also, Congress incorporated the requirement that any increase that is to be taken into account is one that must result from the change. Thus, since in vast numbers of circumstances, applying an “actual-to-potential” test will result in finding significant emissions increases when in fact no such increases, and often reductions, would result from the changes, the “actual-to-potential” test is unlawful. Accordingly, state and local permitting authorities should now reject that test.

In addition, states’ adoption of an “actual-to-potential” test should not be approvable as an alternative to the “actual-to-projected-actual” test in the final rule. Based upon the evidence presented, EPA properly concluded that the “actual-to-potential” test creates significant disincentives to undertaking efficiency projects and others with associated air quality benefits. Thus, in addition to being unlawful, the “actual-to-potential” test would not be approvable as equivalent to the “actual-to-projected-actual” test from an air quality standpoint.

### III. PALs, CLEAN UNITS, AND PCPS

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**Overview of Reforms.** The final NSR rule includes three reforms that establish applicability provisions that are exceptions to the basic NSR applicability scheme. These are: (1) PALs; (2) Clean Units; and (3) PCPs. A PAL is a voluntary source-wide cap on emissions that, once established, results in the source not being subject to major NSR during the life of the PAL, unless it wishes to increase its emissions above the PAL level. Clean Units are units that have either installed emission controls determined to be BACT or LAER, or controls that have been determined to be equivalent to such NSR controls. PCPs are emission control projects that result in net overall environmental benefits.

**Key Features.** PAL emissions caps are set on a pollutant-specific basis for a term of 10 years at the level of a source's "baseline actual emissions," plus the "significant" emissions level for the pollutant. PAL levels cannot be increased during the term unless emissions from all units emitting more than "significant" levels are adjusted to meet current BACT levels. Clean Units are ones that are determined to meet the NSR emission control objectives and, for that reason, are excluded from being considered in NSR applicability determinations for a period up to 10 years. PCPs are projects that are identified in the final rule as presumptively environmentally beneficial or ones that are determined to be environmentally beneficial on a case-by-case basis. PCPs are excluded from NSR applicability because they are environmentally beneficial and thus not properly regulated under a program that addresses changes that increase emissions.

**Response to STAPPA/ALAPCO.** STAPPA/ALAPCO raises a number of objections to the PAL, Clean Unit, and PCP provisions. In the case of PALs and Clean Units, STAPPA/ALAPCO's proposed "improvements" would result in PALs and Clean Units almost never being established and, as a consequence, would have an adverse air quality effect by not achieving the benefits of the final rule's PAL and Clean Unit provisions. STAPPA/ALAPCO's PCP suggestions would establish additional procedural hurdles that would produce no air quality benefits and reduce the utility of the PCP exclusion. We respond below to STAPPA/ALAPCO's issues and proposals:

- **PALs** – STAPPA/ALAPCO seems to have two principal concerns with PALs: (1) the baseline for non-utility sources is the 2-in-10 baseline adopted in the final rule; and (2) "actuals PALs" authorized under the final rule would not require new emissions controls as long as the source does not want to increase its emissions above its PAL actual emissions cap. With regard to the baseline issue, the discussion above on the new baseline provision explains why the baseline that will be set will be appropriate, reasonable, and legal. With regard to the second issue, actuals PALs will, in most cases, result in emissions of sources being significantly less than they would otherwise be. This is true because sources with PALs will forgo the ability to emit up to their potential emissions level and not be permitted to have multiple increases in emissions up to the "significant" level during the 10-year term. Requiring that a source agree to install additional emissions control as a condition of obtaining a PAL, even though the source is maintaining its emissions below the PAL emissions cap (and oftentimes significantly below those levels), would result in the PAL authorization being of little interest to industry and thus result in air quality benefits not being gained under the final rule PAL provisions. As indicated above, the price of obtaining a PAL – giving up the ability to have the source emit at much higher levels – is already substantial.
- **Clean Units** – STAPPA/ALAPCO raises two principal concerns regarding the Clean Unit authorization: (1) a Clean Unit designation can be made where sources have gone through NSR permitting during the past 10 years; and (2) permitting authorities are authorized to make Clean Unit designations

without going through the full NSR permitting process. With regard to the first issue, Clean Unit designations that are made based upon past NSR permitting will only last 10 years from the date the BACT or LAER determination was made. Thus, while sources will get benefits from having installed BACT or LAER controls in the past, such benefits will lapse within a few years, unless a future determination is made that such controls continue to be "substantially as effective" as then-current BACT or LAER. As to the second issue, permitting authorities have substantial discretion as to the permitting process followed but, at a minimum, the process must be one that is SIP-approved.

- **PCPs** – STAPPA/ALAPCO seems to have no major objection to the PCP provisions. It appears to generally recognize that the projects listed in the final rule that will be presumed to be "environmentally beneficial" will properly receive PCP treatment. It raises concerns about the process to be followed for non-listed projects to be designated as PCPs. But this issue should not be of concern to state and local permitting authorities since they must approve the designation of projects as PCPs and can follow whatever process they believe appropriate. No longer will it be necessary for permitting authorities to make a determination that reducing emissions is the "primary purpose" of a project to be granted PCP treatment, but the permitting authority must make a finding that the project is "environmentally beneficial."